No. 98-932

Supreme Court, U.S.
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In The Supreme Court Of The United States

OCTOBER TERM, 1998

DOMINICK LAROSA and CATHERINE LAROSA,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

REPLY BRIEF OF PETITIONERS

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OCTOBER TERM, 1998

No. 98-932

DOMINICK LAROSA AND CATHERINE LAROSA,

PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

REPLY BRIEF FOR THE PETITIONERS

ESTOPPEL ISSUE

The Government's Brief in Opposition is -- surprisingly and tellingly -- devoid of any meaningful discussion of the conflict among the circuits on the application of estoppel against the Government.

There is good reason for this silence.

Quite apart from the obvious -- there is an irreconcilable conflict -- the Government took precisely the opposite position before this Court on the same issue ten years ago, when it was the petitioner and urged this Court to review essentially the same estoppel issue as in the case at bar.

In *Office of Personnel Management v. Richmond*, 496 U.S. 414 (1990) ("*OPM*"), the Solicitor General successfully petitioned this Court for review of the Federal Circuit's decision applying estoppel against the Government for its affirmative misconduct. 862 F. 2d 294 (Fed. Cir. 1988). The Government's Petition for Writ of Certiorari[1] (" *OPM* Petition") argued that the ruling below could not "be reconciled with this Court's prior rulings refusing . . . to estop the Government . . . ." (*OPM* Petition, at par. 7) It further justified review based on

> the absence of a clear standard for the application of estoppel to the Government [which] has led to the anomalous results like that in the present case and has prompted the development of conflicting standards among the Courts of Appeals.

(*OPM* Petition, at par. 16).

The Government did not stop there. The Solicitor General explicitly noted:

> The Court has left open the question whether "affirmative misconduct" by Government agents may in some cases justify estoppel of the Government. [Citations omitted].

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[1] Petitioners request that this Court take judicial notice of its records in *OPM*, No. 88-1943 and in particular, the Solicitor General's petition for writ of certiorari.

(*OPM* Petition, at par. 16).[2] And, the "uncertain state of the law in this area ... has generated a confusion of approaches to estoppel in the Courts of Appeals," (*Id.*, at par. 19, citing decisions in the Tenth, Eleventh, and District of Columbia Circuits.) Those cases, the Solicitor General admitted, declare that estoppel against the Government may "be appropriate under certain circumstances," *Id.*, at par. 20. Certiorari was granted.

On the merits, this Court painstakingly surveyed the array of contradictory, inconsistent rules which the lower courts had developed, some in reliance on language from this Court's own prior opinions.

> [D]icta in our more recent cases have suggested the possibility that there might be some situation in which estoppel against the Government could be appropriate.

496 U.S. 417, 421. And, the lower courts had seen "numerous claims for equitable estoppel" *Id.*, at 422, due to the "inadequate guidance for the federal courts . . ." *Id.*, at

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[2] Not one of the traditional dangers of estoppel against the Government -- cited by the Government in its petition in *OPM* -- is present here. Estoppel will not result in what the law "does not sanction or permit." *OPM* Petition at par. 8-9, quoting *Utah Power and Light Co. v. United States,* 243 U.S. 389, 409 (1917); nor "give the words of the Executive Branch officials the force of law, while suspending implementation of the conditions established by Congress." *Ibid;* nor "force the expenditure of public funds contrary to the express mandate of Congress," *OPM* Petition at par. 11.

422-423. This Court concluded, "We leave to another day whether an estoppel claim could ever succeed against the Government." *Id.*, at 423.

That "other day" has come; the hodgepodge of contradictory and inconsistent rules justifies review here.

What, then, have become of the "absence of a clear standard," the "conflicting standards," the "shar[p]" conflict, and the "confusion of approaches to estoppel" that the Government clearly perceived in *OPM* and that prompted this Court to grant review in *OPM*? Suddenly, in this case where the Government won below, such conflicts have magically disappeared. But they have not.

To the contrary, yet more cases reflect the conflict. *In re DePaola*, 45 F. 3d 373, 377 (10th Cir. 1995) (IRS may be estopped by a showing of affirmative misconduct as well as the traditional elements of estoppel); *Linkous v. United States*, 142 F. 3rd 271 (5th Cir. 1998) (Estoppel available for affirmative misconduct and the traditional elements of estoppel).[3]

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[3] *Mendrala v. Crown Mortgage Co.*, 955 F. 2d 1132 (7th Cir. 1992); *Bolt v. United States*, 944 F. 2d 603, 609 (9th Cir. 1991) ("Affirmative misconduct (not mere negligence) and a serious injustice outweighing the damage to the public interest . . . .")

Therefore, guidance is sorely needed to resolve this jungle of inconsistent, conflicting rules.[4]

It is no response to argue that no conflict exists "on the application of equitable estoppel to suits for the recovery of erroneous refunds under Section 7405," (Brief in Opposition. at par. 5). The particular government remedy is not the issue, but rather whether the Government may be estopped by its actions in the first place from any recovery, no matter what the vehicle. Section 7405 is simply one of several procedural mechanisms for the Government to recover funds where it believes it has made a mistake. Others (among many) include a suit to reduce an assessment to judgment (Code §§7401, 7402), a suit to foreclose a tax lien (Code §7403) or a suit to collect estate taxes (Code §7404).

Any impact that application of estoppel may have on Code §7405 simply highlights why this case is even more important and more worthy of this Court's review.

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[4] Footnote 2 of the Brief in Opposition misstates the holding in *OPM* and another case. This court has never stated an estoppel rule of general application, but if affirmative misconduct is a requirement, that misconduct is demonstrated by the uncontradicted record here -- the highest ranking official of the Petitioners' IRS district apologized in writing to him for delaying his refunds, told him he was entitled to refunds, and wrote "Mr. LaPosa will receive refund checks ... in a few weeks." Petition for Writ of Certiorari, Appendix - Item 5. *In re DePaolo*, 45 F. 3d 373 (Affirmative misconduct "means an affirmative act or misrepresentation or concealment of a material fact." *Id.*, 377)

Taxpayers who rely on the IRS grant of a refund and spend it (as the District Court thought would always be the case (Brief in Opposition, 4-5)) would feel secure against later allegation of IRS error. Others who invest or save their refunds could not invoke estoppel because they had not detrimentally relied on the correctness of the refund. (This is in contrast to the right of the Government to audit a tax return and collect the additional taxes, even after a refund, a circumstance which by definition is created by a taxpayer error.)

DUTY TO STOP RUNNING OF INTEREST

The Petition cited ample authority for the IRS' legal duty to apply monies it seizes to taxes it assesses, and to do so right away. Nor has the Government ever disputed that general duty. The Government "held and hit" the taxpayers: The IRS would not release their funds, would not apply them to pay the taxes, and as a result, interest on the taxes on the penalties, and on the interest, continued to accrue and be compounded daily.[5]

The Brief in Opposition conveniently ignores the uncontradicted and undisputed fact that the "escrow" was not even in place for 44 days following the jeopardy

---

[5] In stark contrast to the Brief in Opposition's "cake" metaphor, the fact is that these taxpayers suffered the worst possible outcome because the escrow was forced on them. See p. 8-10 below.

assessment. Thus, the Government's factual assertions regarding the escrow, even if correct, are irrelevant. First comes the issue of the IRS' duty on Day 1 after the levy. Since that duty is clear and undisputed, the inquiry should stop there. The Fourth Circuit's sanction of the IRS' failure to credit the seized cash against the assessed taxes while no escrow was in existence conflicts with long-standing precedent in the Courts of Appeals, in this Court, and in statute. Petition for Writ of Certiorari, 16-23.

The Government further argues that this case is not certworthy solely because of the escrow and attempts to distinguish *St. Louis Trust Co. v. United States*, 617 F. 2d 1293 (8th Cir., 1980), supplemented by *Stone v. Commissioner*, 47 TCM (CCH) 1502 (1984), and *Stone v. Commissioner,* 5311-72 (TC March 30, 1987) (Memorandum Sur Order). That attempt is in error. *St. Louis Trust Co.* and its follow-on cases hold that interest on a tax liability stops the day the Government seizes assets, even assets in escrow, because the IRS' levy puts it in constructive possession of the cash.[6]

It is no answer to say that the escrow "prevented the Service from selling the assets." First, there were no

---

[6] Indeed, in this case the Government actually received one payment, for $282,000, and in fact applied it to the taxes just as the law requires for the remainder.

saleable "assets" involved, only cash and cash equivalents. Second, the escrow did not even exist for 44 days after the seizure. The Brief in Opposition would have this Court ignore that inconvenient fact.

RESPONSE TO GOVERNMENT'S INCORRECT DESCRIPTION OF FACTS

We believe the discussion above sufficiently addresses the legal points raised by the Brief in Opposition. However, we cannot allow several serious factual errors in that brief to go unanswered, facts important to the Petitioners' request for review.

By relegating to subordinate clauses the very issues sought to be reviewed, the Government's opposition seeks to obscure and gloss over the principal issues in the case. Moreover, the low-key, casual, clinical tone of the Brief in Opposition tries to lull this Court into a false impression of the seriousness of the fights that have consumed these taxpayers for nearly 15 years. Theirs was no gentle, reasonable dispute among mutually-respecting parties. It was a knock-down, drag-out battle with heavy casualties -- all on the taxpayers' side. The jeopardy assessment resulted in placing $20 million of cash and non-cash property in the hands of the Government. Then the taxpayers appealed these assessments and lost. *LaRosa vs. United States,* 841 F. 2d 544 (4th Cir. 1988). Then the Government was paid more money in the Tax Court settlement. The taxpayers asked for some of the interest

back. Forced to confront the issue by Congresswoman Morella, the IRS admitted its a mistake and refunded $1.5 million to the taxpayers. Then it sued to get that back, plus interest. The dispute was and is bitter.

Petitioners never "requested" that the Government not liquidate their assets to satisfy the jeopardy assessment (Brief in Opposition at 2, par. 1), and never "requested" the Service not to sell the seized assets because of their concern that such a sale would ruin their business. *Id.*, at 6. The escrow was not "an accommodation to the Petitioners,...".

These contentions are untrue, and unsupported in the uncontradicted record. To the extent the Government's opposition depends on them, it must fail. For example, in Petitioners' 1991 Tax Court settlement, approved by a representative of the Chief Counsel of the Internal Revenue Service, the Tax Court held, among other things, that under the escrow and jeopardy assessments, "access to and use of [Petitioners'] money effectively has been restricted and extremely costly to the LaRosas for over four years." (Appendix, Item 9, *infra*) Further, "with the release of all of their funds, the LaRosas will restart their previously successful coal business in West Virginia,..." Thus, it was clear -- and agreed to by the IRS -- that putting the Petitioners' money in escrow had stopped, not preserved, the LaRosas' coal business.

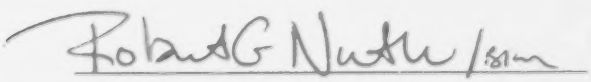
Moreover, the LaRosas submitted ample evidence below in support of their well-pleaded allegations that the "escrow" was coerced and therefore invalid. We urge this Court to consider the sworn declarations of the LaRosa brothers, excerpts from which are in the Appendix (Items 8, 10, 11) in further support of this contention.

In correcting the record, the Petitioners wish to alert the Court that this escrow arrangement was not a voluntary, mutually agreeable, happy "accommodation" among two respectfully disagreeing parties. It was an illegal, coerced contract of adhesion that was invalid because it was not the product of mutual agreement.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,



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APPENDIX - Item 8

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
Southern Division

UNITED STATES OF AMERICA,	*	
	*	
Plaintiff,	*	
	*	
v.	*	CIVIL ACTION
	*	NO. 96-980
	*	
DOMINICK LAROSA	*	
and	*	
CATHERINE LAROSA,	*	
	*	
Defendants.	*	

DECLARATION OF DOMINICK LAROSA

Dominick LaRosa, under the penalties of perjury, declares as follows:

1. I am an individual residing in Maryland. I am making this Declaration to explain some of the circumstances under which the assets of my brother, myself and my wife Catherine, and our corporation, were placed in escrow by the Internal Revenue Service.

2. During the 1970s, my brother Joseph LaRosa, my father Pietro LaRosa, and I worked in coal mines in West Virginia. Together, we built up a substantial

business, mostly supplying coal to utility companies from West Virginia mines.

3. Our company was called The LaRosas International Fuel Company, which was a Maryland corporation. The comptroller of the corporation was my brother, Joseph LaRosa. He has detailed knowledge of the finances of the corporation, as well as of its tax matters. He is supplying a separate declaration to describe many of the issues involved in this tax refund and erroneous refund suit. I would like to supply some details as to how an escrow agreement involving all of our assets operated.

4. Some time in 1984, the Internal Revenue Service began an examination of the corporation's federal income tax returns and liabilities. This examination also included my tax returns and those of Joseph.

5. The IRS eventually determined that the corporation had understated income for certain years and overstated income for other years. As a result, the IRS made adjustments to the corporation's income, and these adjustments flowed through to myself and my brother on our personal income tax returns.

6. On or about December 3, 1985, the Internal Revenue Service made jeopardy assessments against the corporation, as well as against me (and my wife, Catherine) and my brother, Joseph. The total amount of these assessments was over $20 million, but these were eventually reduced to about $3.4 million in tax, $2.5

million in penalty, and $4.0 million in interest (due to the delay in entering the settlement until May, 1991) as a result of an action to contest the assessments in the United States Tax Court.

7. To collect the jeopardy assessments, the Internal Revenue Service levied on property belonging to the corporation and to my family. A complete list of the property that was seized is contained as an exhibit to this declaration.

8. The cash and cash equivalent amounts of funds seized was in excess of $12 million. Of this, $282,669 was actually paid over to the IRS by more than one bank before the escrow was put in place. In addition, substantial other properties were also seized. The total of other, non-cash properties seized was substantially more than $8 million in fair market value.

9. The IRS representatives told us that if we did not agree to the escrow, they would simply liquidate everything else and pay the jeopardy assessments. Of course, that would mean our business was ruined. Faced with this choice, we reluctantly signed on to using the escrow device. The escrow language was entirely the product of the IRS and its attorneys. My attorney proposed many changes, but these were all refused. Among other things, I wanted access to the principal in order to run my business, but this was rejected. This escrow was under threat and under duress. It was the only way the IRS would

agree not to sell everything. The IRS agreed only to very minimal payments, and those from the interest only, toward living expenses. Only about 3% of the income was paid in this way.

10. After these levies, the IRS did not immediately apply the levied property (cash and non-cash) to pay the jeopardy assessments (except for the $286,889). On January 16, 1986, an escrow agreement was entered into. A copy of that escrow agreement is attached to this declaration as Exhibit 1. Pursuant to the escrow agreement, the remaining property which had been levied upon, including particularly the cash and cash-equivalents, was placed in escrow pending the outcome of the Tax Court case described below.

11. We retained counsel to contest the jeopardy assessments. In addition, the IRS sent statutory notices of deficiency to myself and my wife, Catherine, to Joseph, and to the corporation. Our lawyers contested these statutory notices by filing petitions in the United States Tax Court.

12. It took about five years for these Tax Court petitions to be resolved, and they were finally settled in May, 1991.

13. During all of that time, and indeed since January 16, 1986, that is, for five and one-half years, the property described above remained in escrow.

14. Neither I nor my brother had any authority to control the escrowed property. We had to ask the Internal

Revenue Service for money to pay many expenses. These included utilities, gas, auto insurance, school tuition and other items. Any item that was allowed to be paid was allowed only in a grudging way, and after much debate and consideration. Many times these payments were late. I received only a few thousand dollars per month, which was based on the necessities that the IRS said were allowed to be paid. This was much less than the amount earned on those escrowed funds. Even those small payments were sometimes a problem being "approved" by the IRS agent in charge of the escrow.

15. We of course had to pay federal tax on the income that was earned from the escrowed funds, but we were given only enough money to pay these taxes, not the income on which tax was charged. However, we also had to file Maryland State income tax returns, which also had to reflect the income from the escrowed funds as gross income for Maryland State tax purposes. Here, however, the Internal Revenue Service refused to give us any funds to pay our state income taxes until the Tax Court cases were settled in 1991. As a result, we incurred substantial interests and penalty charges for 5 ½ years on these underpaid taxes.

16. The other aspect of the escrow agreement was the principal, as contrasted with the income. There was absolutely no question that the Internal Revenue Service refused at all times to release the principal of the

escrow. So, while at some points the IRS allowed a small portion of the income to be paid to us (to cover living expenses), at no time did the IRS ever allow any of the principal to be released (until the Tax Court cases were settled), and the IRS refused requests to release that principal. Thus, we had no control over the principal of the escrow.

17. At one time, I recall asking for a release of funds so that we could buy another coal business. By our calculations, we demonstrated that even paying that amount would still have left enough for the IRS, but this request was refused.

18. For all of these and other reasons, I did not have unfettered control, or indeed any control, over either the principal (or the income) from the escrowed properties.

Under penalties of perjury, I declare that I have examined the foregoing statement of facts in the foregoing Declaration, and to the best of my knowledge and belief, it is true, correct, and complete.

April 6, 1997 /s/ Dominick LaRosa
Date

APPENDIX - Item 9

UNITED STATES TAX COURT

DOMINICK LAROSA and LORETTA LAROSA,	)	
Petitioners,	)	Docket No. 6171-86
v.	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

DECISION

Pursuant to the agreement of the parties in the above-entitled case, it is:

ORDERED AND DECIDED: That the following statement shows the deficiencies in income taxes and additions to taxes due from the petitioners for the taxable years 1981, 1982 and 1983 without taking into consideration the jeopardy assessments made on December 3, 1985:

1981

Deficiency in income tax, without taking into consideration the jeopardy assessment made on December 3, 1985: $284,407.00

Payments/Refunds	
12/17/85	721.00
12/17/85	23,474.00
04/07/87	<23,474.00>
Total Payments	$ 721.00
Deficiency (to be paid)	$283,686.00

That there is an addition to tax due from the petitioners for the taxable year 1981, under the provisions of I.R.C. §6653(b) in the amount of $85,322.00.

1982

That there is a deficiency in income tax due from the petitioners for the taxable year 1982, in the amount of $820,787.00.

That there is an addition to tax due from the petitioners for the taxable year 1982, under the provisions of I.R.C. §6653(b)(1), in the amount of $246,236.00.

That there is an addition to tax due from the petitioners for the taxable year 1982 under the provisions of I.R.C. §6653(b)(2), equal to 30 percent of the statutory interest due on $770,376.00 from April 15, 1983 to December 3, 1985.

That there is an addition to tax due from the petitioners for the taxable year 1982, under the provisions of I.R.C. §6661, in the amount of $82,079.00.

1983

That there is a deficiency in income tax due from the petitioners for the taxable year 1983, in the amount of $468,081.00.

That there is an addition to tax due from the petitioners for the taxable year 1982, under the provisions of I.R.C. §6653(b)(1), in the amount of $140,424.00.

That there is an addition to tax due from the petitioners for the taxable year 1982 under the provisions of I.R.C. §6653(b)(2), equal to 30 percent of the statutory interest due on $1,060,555.00 from April 15, 1984 to December 3, 1985.

That there is an addition to tax due from the petitioners for the taxable year 1982, under the provisions of I.R.C. §6661, in the amount of $46,808.00.

Judge Entered:

* * * *

It is stipulated that the Court may enter the foregoing decision.

In settling this case with the Internal Revenue Service (hereinafter, "IRS"), the taxpayers, Dominick LaRosa, Joseph LaRosa, and the LaRosa's International Fuel Co., Inc., (hereinafter, collectively, "the LaRosas"), reaffirm and reiterate that their federal income tax returns for the taxable years 1979 through 1983, the years covered

by the Settlement Agreement, were filed correctly and properly under federal and state tax law.

The LaRosas are settling this case for the reasons stated in this settlement memorandum and specifically reserve all rights open to them to appeal or to otherwise contest their tax liability with the State of Maryland (hereinafter, "Maryland"), including their right to apply for a pardon from Maryland.

In settling this case with the IRS, the LaRosas state that they have committed no wrong in filing their federal and state income tax returns for the years covered by the Settlement Agreement, 1979 through 1983. The LaRosas deny committing any act or omitting any income that would cause any addition to tax under the Internal Revenue Code (hereinafter, the "Code"). The LaRosas enter into this Settlement Agreement for the sole and only purpose of finally disposing of these United States Tax Court cases with the IRS.

The LaRosas maintain that their company intended to file and did file its 1979 and subsequent year federal and state corporate income tax returns and reported the income from the contracts involved in these cases on the completed contract method of accounting (hereinafter, "CCMA"). The LaRosas maintain that in 1979 when they obtained their first contracts that they kept their books on the CCMA. The LaRosas maintain that all the contracts involved in these cases consist of long-term contracts. The

LaRosas maintain their company filed an election on its 1979 federal income tax return electing and advising the IRS that it was electing CCMA. The company's originally filed 1979 federal income tax return has been lost by the IRS. The LaRosas maintain their company was entitled to use the CCMA from 1979 through 1985 in reporting the income from the contracts involved in this case. The LaRosas and their company maintain they properly and timely filed, timely reported, and timely paid tax upon all the income from the contracts.

The LaRosas have agreed to settle for the following reasons;

First, to try and possibly appeal this case would be a lengthy and costly process. This case probably would not be decided by the Tax Court for at least twelve (12) months or longer. The LaRosas also recognize the substantial possibility that the IRS would appeal any verdict unfavorable to the IRS, and appeal process which would probably consume more than a year. Thus, even when the LaRosas secure the favorable verdict, which they fully expect, the trial and appeal is expected to continue for more than two (2) years from the trial date.

Second, settlement will release all the money to them which the IRS has held under jeopardy assessments for over four (4) years. While the LaRosas maintained upon assessment, and continue to maintain, that the jeopardy assessments were improper, the reality is that

access to and use of their money effectively has been restricted and extremely costly to the LaRosas for over four (4) years.

With the release of all of their funds, the LaRosas will restart their previously successful coal business in West Virginia, thereby employing several hundred currently unemployed workers and producing substantial revenues for the federal and state governments. Moreover, a prompt release of the money currently levied against by the IRS is essential to securing several lucrative coal supply contracts which must be bid on within the next several months. Prominent individuals concerned with the West Virginia's and Maryland's economies have implored the LaRosas to settle with the IRS so that they could restart their coal business and bring an immediate economic benefit to the various governments.

Third, the LaRosas recognize the inherent litigation risk in proceeding with a trial, even though they and their legal counsel believe their case is totally meritorious and that they would win.

Fourth, the LaRosas' tax advisors have advised them that settlement would enhance their tax planning capability for the taxable year 1990.

Fifth, the emotional toll on the LaRosas and their families has been devastating, and they want to end this nightmare of almost five years duration. For example, the LaRosas' parents are elderly and are experiencing health

problems which normally affect their age group. The LaRosas recognize their parents' anguish over this case and believe that settlement is necessary to remove this parental concern and potential health detriment. Additionally, the strain on the wives of Dominick and Joseph LaRosa is acute, and Dominick LaRosa recognizes that his children have been and will continue to be adversely affected by protracted litigation.

Finally, the LaRosas believe that this settlement establishes the principle and demonstrates what they have always advanced with the state and the IRS -- that as taxpayers they were always, and are willing to pay their proper and fair share of taxes to the federal and state government.

That the petitioners waive all litigation costs incurred in this proceeding pursuant to the provisions of I.R.C. §7430.

It is stipulated that the petitioners have reserved the right to pursue an action in the appropriate federal court with respect to the interest claimed to be due by the I.R.S. on the respective deficiencies.

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
Southern Division

UNITED STATES OF AMERICA,	*	
	*	
Plaintiff,	*	
	*	
v.	*	CIVIL ACTION
	*	NO. 96-980
	*	
DOMINICK LAROSA	*	
and	*	
CATHERINE LAROSA,	*	
	*	
Defendants.	*	

DECLARATION OF JOSEPH LAROSA

Joseph LaRosa, under the penalties of perjury, declares as follows:

1. I am an individual and a resident of the State of Maryland. I am making this Declaration to tell the Court some of the circumstances under which my brother, Dominick LaRosa, received the tax refunds at issue in this case.

2. I was (and remain) the Comptroller of the Corporation. In that capacity, I have personal knowledge of

its operations. This knowledge includes monitoring its receipts and disbursements, its tax payments and liabilities, and other aspects of its finances. Because of the IRS audit described below, I also came to have knowledge of Dominick LaRosa's personal finances, including his tax payments to the IRS over the years from 1981 to the present. I have also examined IRS transcripts of account, specifically the account transcripts relating to Dominick, the Corporation and myself. Finally, I was in charge of monitoring the tax aspects of the Tax Court settlement described below, assisting our attorney at the time. I also monitored, through my own calculations, the taxes, penalties and interest charged by the IRS and reflected in the claim for refund.

3. My brother, Dominick LaRosa, and his wife, Loretta Catherine LaRosa, also reside in Maryland. They are the Defendants in the above-captioned action.

4. During the 1970s, my brother, Dominick LaRosa, and my father, Pietro LaRosa, and I worked in coal mines in West Virginia. Together, we built a substantial business to supply coal from West Virginia mines to utility companies.

5. Our work was performed through a corporation, The LaRosas International Fuel Company. This was a Maryland corporation owned by my brother, Dominick, my father, and myself.

6. Over the years, and through the late 1970s and early 1980s, the corporation gained many contracts with utility companies that involved many millions of dollars of sales.

7. Shortly before December 3, 1985, the Internal Revenue Service formally opened an income tax examination of the corporation's federal income tax returns and liabilities. The years under examination for the corporation were 1979 - 1983.

8. The IRS also opened income tax examinations of myself and my brother, Dominick. The years under examination were 1981 - 1983.

9. As I describe more fully below, the Internal Revenue Service determined that the corporation had understated its income for certain years (the earlier years) and overstated income for other years. The resulting understatements and overstatements of income were then attributed to myself, personally, as well as to my brother, Dominick and his wife Catherine.

10. On December 3, 1985, the Internal Revenue Service made jeopardy assessments against the corporation, as well as against Dominick and Catherine, and myself. The total amount of these jeopardy assessments was in excess of $20 million. Eventually, as I explain below, these amounts were reduced to about $9 million (including penalty and interest), as a result of a settlement in the United States Tax Court.

11. To collect the jeopardy assessments, the IRS levied on property belonging to my family and to the corporation. A complete list of the property levied upon is contained in Exhibit 1. (This list is also an exhibit to the declaration of Dominick LaRosa.)

12. The fair market value of the property levied upon was in excess of the amounts eventually determined to be due under the Tax Court settlement that we eventually filed to contest the jeopardy assessments. The approximate value of the cash and cash-equivalent property was $12 million. That property, if applied to Dominick and Catherine's taxes and that of myself and the corporation, would have fully paid those taxes as eventually and finally determined by the Tax Court. (Other non-cash property was also seized.)

13. After the December 3, 1985 levies, the Internal Revenue Service did not immediately apply the levied property to pay the jeopardy assessments. On January 16, 1986, an escrow agreement was entered into. A copy of this escrow agreement, together with a list of the escrowed property, is attached as Exhibit 1. Pursuant to the escrow agreement, property which had been levied upon was placed in escrow pending the outcome of the Tax Court case.

14. The family retained counsel to contest the jeopardy assessments. Pursuant to Section 7429 of the Internal Revenue Code, a Complaint was filed in the United

States District Court for the District of Maryland seeking to contest the reasonableness of the jeopardy assessments. After a hearing, the Federal District Court found that the making of the assessments was "reasonable" and dismissed the Complaint. The dismissal of the Complaint was upheld on appeal.

15. Following the jeopardy assessments, the Internal Revenue Service also issued formal notices of deficiency, which I have learned are required by law.

16. These notices of deficiency describe the process by which a taxpayer is allowed to contest the assessments in the United States Tax Court by filing a Petition.

17. Through our attorneys, Dominick and Catherine, the corporation and I filed Petitions with the United States Tax Court to contest those notices of deficiency.

18. On or about May 1, 1991, more than five years after the jeopardy assessments, these Tax Court cases were settled. I have attached as Exhibits 2,3 and 4, copies of the formal settlement papers. These decisions provided that, during the years 1979 - 1983, the corporation, Dominick and Catherine and I were liable for amounts totaling $4,972,507 of income tax and penalties, as set forth below. It is to be noted that the settlements, by their terms, were just that -- settlements.

[Table Omitted]

* * * *

42. Paragraphs 10-13 above describe the fact that our family's property was placed in an escrow account for 5-1/2 years, while the Tax Court case was pending. However, even though the escrow agreement was signed in January 1986, it was by no means a voluntary act.

43. At that point, the Internal Revenue Service had seized all of the family's liquid assets and all of our business assets. Because of these seizures, we had absolutely no way to run our business, and we stood to default on multi-million dollar contracts.

44. Internal Revenue Service representatives told us in no uncertain terms that the escrow option was available, but that if we did not "agree" to it they would simply liquidate everything they could and pay the jeopardy assessments. They had already seized and applied $282,669. That, of course, would have meant the ruin of our business that we had spent so much time to develop.

45. Accordingly, under the duress and threat of a ruined business enterprise, we were forced to sign the escrow agreement. It was not voluntary on our part. It was the only way the IRS would agree not to liquidate all the assets it had seized.

46. The operation of the escrow agreement showed that the Internal Revenue Service had complete control over the funds. First, at no time during the life of that agreement were we ever permitted to have access to the principal of the agreement. At most, and under difficult circumstances, the IRS permitted certain amounts from income to be paid for living expenses. But this in no way affected the fact that the IRS, from the time of the seizures, had complete and unfettered possession of the corpus of the escrow agreement. Under no circumstances would the IRS agree to release the corpus. Only on May 14, 1991 was the escrow finally released. Exhibit 13.

47. During the course of this agreement, Dominick and Catherine needed funds for many different purposes. School for the children was necessary, the payment of state income taxes was necessary, and many other expenses were necessary to be paid from the income from the escrow agreement. On many occasions he and I asked the Internal Revenue Service to release funds. In almost every case they were slow to release the funds or they were late releasing the funds. The result was in embarrassment and monetary penalties on the part of our creditors. In fact, until the end of the escrow, the IRS would not even release money to pay the Maryland State income taxes due on the income from the escrowed assets. As a result, we incurred substantial penalties and interest from

the State of Maryland, and were forced to spend considerable legal fees.

48. For these and other reasons, Dominick and Catherine did not consider that they had unfettered control, or any control, over either the principal or the income from this escrow agreement.

49. Since we had no control over the escrowed amount or the income from it, all of which was subject to the IRS' "veto" according to the terms of the escrow agreement, we could not devote the principal or the income from the agreement to other purposes. Those purposes would have included the expansion and operation of our business. Without those funds, the corporation today is a much smaller enterprise and far less profitable than it could have been had we been able to invest the principal that belonged to us.

50. During the course of the events described above, I had occasion to prepare computations relating to the claim for refund filed by our attorneys after the Tax Court settlement. In these computations, which are attached as Exhibit 14, I calculated how much interest the IRS charged (per federal tax interest rates on underpayments) from December 3, 1985 through the dates that Dominick LaRosa was given his two refunds in 1994. Under the claim for refund, that interest should not have been charged, and so when the claim was prepared, that was the amount of interest that was claimed as being due to

Dominick (plus interest). The chart below summarizes that computation, and also sets out the actual refunds which Dominick received as offsets. The differences are the amounts that should be refunded in this lawsuit (plus interest):

[Table Omitted]

51. I declare, under the penalties, that I have examined the foregoing Statement of Facts and the foregoing Declaration, and to the best of my knowledge and belief it is true, correct and complete.

April 6, 1997
Date

/s/ Joseph LaRosa

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
Southern Division

UNITED STATES OF AMERICA,	*	
	*	
Plaintiff,	*	
	*	
v.	*	CIVIL ACTION
	*	NO. 96-980
	*	
DOMINICK LAROSA	*	
and	*	
CATHERINE LAROSA,	*	
	*	
Defendants.	*	

SECOND DECLARATION OF DOMINICK LAROSA

Dominick LaRosa, under the penalties of perjury and pursuant to 28 U.S.C. Section 1746, declares as follows.

1. I am a defendant and counter claimant in the above-entitled case, and I am making this second declaration to further explain some of the circumstances surrounding the creation of the escrow agreement at issue in this lawsuit.

2. First, some background is necessary. The LaRosa's International Fuel Company, Inc., which was run by myself, my brother Joseph, and my father Pietro during

the 1980s, was advised to use the long-term completed contract method of accounting in order to account for long-term contracts we had negotiated. These were with major utilities that used coal for their electric generating operations. The most important of these utilities was the Allegheny Power Systems. This method was selected upon the professional advice of our accountants. Since the contracts were due to be completed by the end of 1985, we were advised and were prepared to report all of the income from these contracts in our 1984-1985 taxable years. This method of accounting for long-term contracts, we were advised, is fully sanctioned by the Internal Revenue Code. It meant that the income from the contracts would not have to be reported in the early years (1981-1983), but only in the later years of the contract. It was for this reason that there were reported large amounts of money in 1984-85 and lesser amounts in 1981-83.

3. The Internal Revenue Service's levy on December 3, 1985, upset our entire plans for the Corporation, to say the least. About forty-five days after these jeopardy levies, seeing that our business was totally shut down and all of our assets were seized (business and personal), an escrow agreement was entered into involving the assets that were seized.

4. Under no circumstances could this escrow be considered one that I "agreed to" voluntarily. It was forced on us and coerced by the IRS. The IRS had seized

all of my and my corporation's liquid and non-liquid assets. By that act, the IRS completely deprived me, my brother, my father and the corporation of the ability to do business. The IRS had even seized our cars, business equipment and other items of property. The Corporation and I faced total economic ruin if we did not "agree" to the escrow.

5. The so-called "agreement" to form the escrow was not an act of free will. It was not a matter of choice. If we did not "agree" to it, the IRS insisted it would liquidate everything -- that is, all of the property and money -- and apply these to the $20 million of assessments it had made, assessments which were later settled at less than half of the original amount. The IRS ended up keeping the property in escrow for 5-1/2 years.

6. I have also read the motion papers of the United States in this matter, wherein it contends that the refunds it issued to me and my wife in 1994 were in error. While I understand that this is the position the Government takes today, it certainly was not what the IRS said in 1994 when the refunds were issued. In fact, when I applied for these refunds, not only did the IRS believe the refunds were warranted because it had charged too much interest on the original taxes, but the IRS also apologized to me for the inconvenience it caused by keeping all of the money as long as it had. A copy of the letter I received from the IRS (and which was addressed to my Congressperson, Ms. Morella)

is attached to this Declaration as Exhibit 1. This letter reads in part as follows:

> We are sorry that Mr. LaRosa's dealing with the Internal Revenue Service have [sic] been less than satisfactory. Please be assured that we share your concern that all taxpayers receive efficient and courteous treatment....Please extend our apology to Mr. LaRosa for any inconvenience this may have caused.
>
> I have been told, and I understand, that legally the United States can still ask for the refunds back in this lawsuit despite this letter, but in 1994 when the refunds were issued both I and the IRS believed they were correct.

7. So, not only did the IRS make a jeopardy assessment against me in 1985, but in the end, it was settled for less than half of the original jeopardy assessment. When, through my lawyers, I applied for a refund of interest, it took the IRS another three years to grant that refund (apologizing for the inconvenience it "may" have caused -- an understatement if there ever was one). To add insult to injury, two years after that it has sued me to get that refund back, and claims interest on top of that!

8. I have also read the Plaintiff's Reply concerning the operation of the escrow account. The statements in that legal brief do not appear to be verified by any declaration, and in some respects, they are completely wrong. For example, my brother Joseph and I were not

given $20,000 per quarter as it suggests, but only about $9,000 per quarter, or $36,000 per year for certain living expenses. Second, all of the other expense categories noted in the Plaintiff's brief were normal expenses of living, including what is called "private school tuition" which included college tuition for my daughter. The oil and gas investment was a legally binding contract that was entered into before the jeopardy assessments, so the IRS apparently agreed to pay this. This was to protect the IRS in any event, because these investments were very valuable at the time.

9. The legal and accounting fees category was almost solely the result of the IRS' jeopardy assessments, and the efforts my family had to expend to settle the Tax Court litigation and fight the jeopardy assessment case. These expenses would not have been incurred if the IRS had not made their jeopardy assessments.

10. It is a misstatement that our corporation and business kept going while the 5-1/2 years of the Tax Court litigation continued. The fact that the IRS had tied up all of my family's assets by way of the escrow meant that we could not operate the business, and it remained in a dormant state for those years, and after. It remains largely dormant today, though I am trying to revive it. To claim, as the Plaintiff's brief does, that the business did so well that we could write a check for $3.6 million in 1991 is also wrong. In fact, we could not. In fact, the $3.6 million

check was issued by the Corporation after that amount of money was transferred from the escrow to the Corporation at the conclusion of the Tax Court litigation. Specifically, at the time it was agreed to transfer the cash from the Corporation's account with American Capital Financial Services, Inc., where the Corporation had more than the $3.6 million (in escrow) in the American Capital Government Securities Fund. This source is noted in my brother Joseph LaRosa's Declaration, specifically at Exhibit 1, on the 6th page following the escrow agreement.

11. Even though the Plaintiff's Reply brief is not verified on the subject if the disbursements from the escrow, and is factually incorrect, it is also incomplete. For example, it does not state the fact that in many cases, the IRS failed to allow payment of many personal expenses, or where it did, they were late. The insurance payments were often late because of the IRS. The electric and gas bills were often late, with cutoff notices coming to my home for the first time in my life. On top of this, the IRS' jeopardy assessment caused the Corporation to lose the renewal of its contract with Allegheny Power Systems. That contract could have lasted for up to 30 years, with hundreds of millions of dollars in sales. There were other items detailed in my previous declaration which were not paid or not paid timely.

12. At no time did the IRS ever agree to let my family have access to the principal of the escrow. As noted,

the only access we had to the interest in part, and even that access was grudgingly given.

13. The United States apparently has possession of the checks from the escrow account. I do not. I have not had an opportunity to review all of the escrow checks since these have not been provided to me in this litigation. Thus, I cannot fully determine whether the statements made in the government's brief, even if they were verified, are otherwise be true.

* * * *

5/7/97

Date /s/ Dominick LaRosa